

# THE BOND BUYER

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## Fed's CP Plan Draws Interest of States

*Massachusetts, Others May Push to Join*

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By [Patrick Temple-West](#) and [Michelle Kaske](#)

WASHINGTON - The Federal Reserve announced yesterday that it will buy commercial paper directly from issuers to provide liquidity to the short-term market, prompting officials from Massachusetts and other states to say they may push to participate in the program.

Fed and Treasury Department officials could not say definitively if tax-exempt commercial paper would be accepted under the program. But issuers, eager for relief from high, short-term borrowing costs, said the program should help stabilize the variable-rate market. They also said that the description of the program that the Fed issued yesterday can be interpreted to include municipal issuers.

Meanwhile, Fed chairman Ben Bernanke hinted at the possibility of a rate cut in a speech at the National Association of Business Economists conference here.

The Fed said that under its new commercial paper funding facility, it will create a special purpose vehicle that will purchase three-month unsecured and asset-backed commercial paper directly from eligible issuers. The SPV will buy the commercial paper at a spread over the three-month overnight index swap rate. But the Fed said it may consult with market participants to determine appropriate spreads that mimic more normal market conditions.

Interest rates for tax-exempt commercial paper are closely associated with variable rates set by the Securities Industry and Financial Markets municipal swap index. The SIFMA index was 5.74% as of Oct. 1, down from 7.96% the week before.

The facility will only accept commercial paper rated A1 or better issued by U.S. issuers. The maximum amount a single issuer could sell to the SPV would be the average amount of commercial paper it had outstanding in the month of August 2008 less any amount of its outstanding commercial paper held by investors other than the SPV. The program will terminate on April 30, 2009, unless the Fed agrees to extend the facility.

Issuers said the Fed's program would ease the borrowing costs for tax-exempt, short-term commercial paper and could also help stabilize the short-term market.

The Fed "could have a stabilizing effect on our commercial paper program," said Tom Dresslar, a spokesman for the California state Treasurer's Office. California has about \$1.5 billion in outstanding commercial paper and rolled \$225.9 million over yesterday, he said.

The Fed program also "could create some additional capacity on the part of the money market funds to buy our [revenue anticipation notes]," he said, referring to California's plans to sell between \$3 billion and \$7 billion of Rans next week.

Massachusetts officials said yesterday that they may utilize the Fed's new commercial paper funding

facility to help the commonwealth raise money as current borrowings in the short-term market are at a standstill. "Our goal is to always finance the state's borrowing needs at the lowest costs to taxpayers," said state Treasurer Timothy Cahill.

"Although we haven't seen details of the Federal Reserve's plan, we will review it carefully as soon as possible to determine what direct benefit it would have for the commonwealth. That being said, any federal action that boosts investor confidence to jump-start the credit markets, we obviously support."

Commonwealth Treasury officials said they are in discussions with the U.S. Treasury Department regarding possible borrowing options for the state.

Andrew Williams, a spokesman with the Federal Reserve Bank of New York, said he could not confirm that the funding facility will extend to municipal issuers. The statement issued by the Fed "doesn't indicate that would be the case," he said.

Government officials and their representatives said they should be included in the program.

"The tax-exempt municipal market has short term problems too," said Lawrence K. Dallia, bond finance manager for Wisconsin. It would be "a glaring absence" by the Fed to overlook municipal issuers, he said, adding, "If it's good for the goose, it ought to be good for the gander."

One representative of a state and local government group said: "Our interpretation of the rules believes that government commercial paper is included."

Corporations issue short-term paper to pay for day-to-day expenses. Municipalities, often universities and hospitals, may issue tax-exempt commercial paper to fund daily costs for a construction project before issuing longer-term revenue bonds to pay the project's total cost.

Massachusetts official said the Fed program could help the Bay State obtain short-term financing as it was unable to complete a planned commercial paper transaction on Sept. 29 when the market began to freeze up. Overall, Massachusetts issued roughly \$600 million of commercial paper in the first quarter of fiscal 2009, which began July 1, about \$200 million less than what officials wanted to sell, according to Cahill.

In addition, state officials yesterday postponed for the second time a \$750 million revenue anticipation note deal that would have helped the state's cash flow needs until tax-income revenues arrived in the spring. While Massachusetts can meet its most immediate obligations, such as quarterly local aid payments, by tapping into cash on hand or its rainy-day funds, officials would prefer to use the short-term market.

The Treasury has already drawn down \$310 million of the \$400 million of reserve funds the legislature previously approved. Further dipping into rainy-day funds would require legislative approval.

"We expect that the tightness that we experienced in September with [paying] local aid will probably be exacerbated in December," Cahill told reporters last week after speaking at Information Management Network's sixth annual New England Public Finance Conference in Boston. "Generally it's a very slow time for revenues in December anyway and given the economy, maybe a slower time than we would normally face."

In his remarks, Bernanke said the Fed's expanded lending programs will help firms cope with reduced access to the usual sources of funding. He also hinted at a possible rate cut saying "the outlook for economic growth has worsened" and "downside risks to growth have increased."

"In light of these developments, the Federal Reserve will need to consider whether the current stance of policy remains appropriate," Bernanke said.

The Fed's next meeting is scheduled for Oct. 29.

*Rich Saskal contributed to this story.*

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